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Unemployment Benefit Duration and Startup Success: Evidence from Germany

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We assess how the potential benefit duration (PBD) of the unemployment insurance (UI) affects the actual unemployment duration of founders, their motivation for starting up and the quality of their firms. Though a relevant share of all new firms is started out of unemployment, research has focused on analyzing UI with respect to reemployment. To analyze the effects of UI benefit duration on founders, we are the first to create a new representative dataset on founders in Germany that links administrative social insurance with survey data. Exploiting reform-based and age-based exogenous variation in PBD within the German UI system, we derive causal effects using an instrumental variable approach that entails the features of both difference-in-difference and regression discontinuity design. We find that longer PBD leads to longer actual unemployment duration of those becoming self-employed, the UI duration elasticity being higher than for those becoming reemployed. With increasing unemployment duration, the founders' outcomes in terms of self-assessed motivation, sales, and employment growth become inferior. This net causal effect can be rationalized by PBD affecting the relative value of becoming employed more than the outside option of starting a business which is less dependent on e.g. stigma from the employer side. Our paper suggests that the fiscal externality of UI on startup success should be considered for the (optimal) design of the UI system.